The Real Estate ANALYST

OCTOBER 22 1954

Volume XXIII

Number 45

As I see

THE SOCIALIZATION OF CREDIT

IN 1848, the Communist League commissioned Karl Marx and Friedrich Engels to draft a manifesto embodying the communist principles. This document has been the "Magna Charta" of communism from that time to the present, and this is the document which ends with the statement which for many generations was the battle cry of the radicals: "Let the ruling classes tremble at the prospect of a communist revolution. Proletarians have nothing to lose but their chains. They have a world to win. Proletarians of all lands, unite!"

The Communist Manifesto described 10 measures which could be used in the most advanced countries to wrest by degrees all capital from the bourgeoisie and to centralize all instruments of production in the hands of the State. The fifth of these 10 measures dealt with the centralization of credit in the hands of the State.

During the big depression of the thirties, real estate foreclosures went unusually high, the prices of properties dropped, mortgages were almost unobtainable, and new building fell to practically nothing. We had previously adopted a number of the other provisions of the Communist Manifesto, such as a heavy progressive or graduated income tax (the second method listed), and while we had not abolished all rights of inheritance (the third method listed), we had gradually upped the inheritance tax until we probably scored at least fifty percent on this point. We set up later a Federal agency known as the Federal Housing Administration to "insure" mortgages in order to make money readily available for the financing of real estate. I think the term "insure" was badly selected, as what the FHA actually does is 'guarantee' mortgages. The concept of insurance brings to mind actuarial processes by which risk is scientifically appraised, with a premium scientifically computed to accumulate the necessary reserves.

The insurance or guaranteeing of mortgages is unnecessary during the early part of a boom, as there are practically no fatalities during inflationary periods. Foreclosures rise only when the price level falls, and, as these drops in the price level cannot be accurately predicted either as to the time of their occurrence or the percentage of drop, it is impossible for an actuary to arrive scientifically at any premium rate which will accumulate the necessary reserves.

The whole concept of guaranteeing mortgages is not new. There were a number

of mortgage guaranty companies operating in the United States during the twenties, but since it was impossible to compute a scientific rate and the rate actually charged was insufficient, these companies went bankrupt during the depression of the thirties. The Federal Housing Administration as a guaranteeing agent has the advantage of being a semiofficial body with the full credit of the United States Government behind it. It cannot go into receivership, but it can socialize the loss should another heavy foreclosure period arrive at some time in the future.

Forty-two percent of the outstanding mortgages in the United States at the present time are guaranteed by either the Veterans Administration or the Federal Housing Administration.

The new housing act lowers the down payment on a house by a very large percentage. A $12,000 house, for instance, formerly required under the FHA provision a down payment of $2,400. The new act reduces this by half to $1,200. In addition to reducing the down payment, it has provided for a longer period during which the loan is paid off, which, of course, results in the fact that the Federal Government is guaranteeing a larger percentage of the mortgage for a longer time.

There can be no question of the fact that the immediate effect of the new housing act is quite stimulating both to the volume of new residential building and to the sales market for existing buildings. I rather suspect that the home builder and the real estate broker, who have been so vehement in their criticism of Government subsidies and of Government interference with business, will accept with open arms these new provisions which during the next few years will increase their volume of business. I also suspect that the more liberal guaranteeing provisions on existing homes will increase the market price at which these homes will sell during 1955, and will preclude any large drops in average selling prices on existing buildings.

Since one of the very substantial props beneath our present business boom is the tremendous volume of new construction, the new housing act will strengthen this prop during 1955 and will probably ensure a continuation of the boom for at least another year. If this were the only effect of the new housing act, I would find myself quite enthusiastic about it as I dread, as most people do, the readjustment in our economy which I believe must come sooner or later.

I was quite interested in the transcript of Housing Administrator Albert M. Cole's conference with U. S. News & World Report, printed verbatim in its issue of October 22, 1954. One of the questions asked Mr. Cole was:

> Q. Do you have any figures on the carry-over on houses the way they do on farm products? If you built 1.2 million last year, are you sure that all of those were sold?

A. We have figures which would indicate whether or not they were sold. For instance, FHA single-family homes are sold only to owner occupants. That 's true of VA, too. There is no substantial inventory showing up in unsold houses approved for FHA or VA mortgages. If there were a saturation point reached, and those builders were having difficulty marketing their houses, then that fact would soon show up and the agencies would clamp down.

If I read this statement correctly - and it seems to me that there is only one interpretation - the building situation is still sound, but just so soon as vacancies start to appear in quantity, the FHA and the VA will start tightening their loan requirements. This would be a natural course for them to follow, as the risk in guaranteeing large quantities of housing from then on out would be great. However, when vacancies start to appear in quantity, building will already be dropping, and to tighten credit on home loans at that time would accelerate the drop and intensify the readjustment in the housing field. The time for tight credit is when the housing boom is at its peak and the time for loose credit is when very little building is going forward. I believe that the FHA could be used as a stabilizing factor on new building by helping to fill in the valleys by cutting off the tops of the booms. I am not at all certain that it will be used in this way.

This criticism of the FHA is a criticism of its mechanics. A more fundamental criticism, in my opinion, is the fact that it represents a very decided and effective socialization of housing credit. There may be those in the real estate and building field who believe that the Government can be counted on to subsidize their business through the insuring of unsound loans without exercising a strict Government control of what they do and how they do it. There can be no subsidy in any field without corresponding Government controls. The farmer wanting high price supports for his crops found that this inevitably entailed limitations on the acreage he could plant and the type of crops he could raise, and the builder is going to find that the Government agency guaranteeing loans on his houses must necessarily for its own protection control the type of house he builds, the location in which it is built, the method of construction and the profit that he makes on the deal.

The real estate broker is now finding out that the guaranteeing of a mortgage loan on a house by the FHA involves a conditional contract of sale which can be voided within 7 days by the purchaser if the negotiated price is above the amount of the FHA appraisal.

The provision in the new housing act that the purchaser must be shown a copy of the FHA appraisal on the property is practically equivalent to Government price-fixing on the property. This I have always opposed. In every field of endeavor there are high-cost producers and low-cost producers. The products they produce are in competition on an open market. The consumer is the final judge of the

relative value in relationship to the price asked. Just so soon as any Government agency attempts to fix prices, these prices are necessarily high enough to enable some of the higher cost producers in the market to stay in production. We are currently seeing the effect in the FHA scandals of FHA appraisals which were set high enough to take care of high-cost producers, with low-cost producers mortgaging out with large windfall profits. On the other hand, if the price fixed by the Government is below the price of many producers in the market, these producers are automatically forced out of production, restricting output at a time when the output may be needed to take care of the demand.

I am not afraid of high prices, as I have always said that the best cure for high prices is high prices. In a free market, if the price of any product is high in relationship to its cost of production, many people try to produce in order to take advantage of the profit markup, with the result that the market is oversupplied. Because the market is oversupplied, the price drops. No Government controls can be as effective as the natural reactions of the market itself.

It is hard to say, when socialization starts in any field, how far it will continue before free enterprise breaks down and Government takes over the entire job. A study of the past is not reassuring. When the camel has gotten his nose under the tent, it has generally been a short time until those who erected the tent for their own protection were crowded out.

We may experience something of this sort in the next few years in the United States. It is going to be rather difficult for savings and loan associations and private lenders to compete with what I consider the unsound loans being insured by the FHA unless they, too, crawl under the protection of the Government agencies.

When some economic historian of the future looks back and writes the economic history of the last 25 years, I am afraid that he may point out that free enterprise in the housing and real estate field was eventually destroyed by the socialization of housing credit and the controls over the industries involved, which the guaranties of unsound loans necessarily required.

It is always wise to remember that a Government powerful enough to give you the things you want is also powerful enough to take from you the freedom and independence you prize.

Roy Wenzlick

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